

Effect of Internal Control Activity on Financial Accountability and Transparency in Local Government Areas of Borno State, Nigeria

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Abstract

Local governments in Nigeria being the closest tier of government to the people, occupies a strategic position in public governance. The ordinary expectation is that it should impact meaningfully on the life of the people. However, these objective remains largely unachieved due to lack of financial accountability and transparency in the utilisation and management of public funds. Internal control activity is an important mechanism of transparent and accountable financial resources utilisation in an organisation. This study therefore examines the effect of internal control activity on financial accountability and transparency in local government areas of Borno State, Nigeria. The study was carried out using cross sectional survey design. The study drew a sample of 330 out of 1886 staff of the Treasury and Finance, Administration, and Audit Departments and the Local Government Council Members out of five of the local government areas of Borno State. The data for the study were collected through the use of the questionnaire instrument. The data collected were analysed using descriptive statistics, chi-square statistics as well as regression analysis. The result of the chi-square statistics revealed that internal control activity is ineffective in the local government areas of Borno state. The regression results revealed that internal control activity has insignificant impact on financial accountability but has positive impact on financial transparency in the local government areas of Borno State. The study therefore recommends that Borno state government through the Ministry of local government affairs in conjunction with the local governments' management should revisit the policies and procedures of internal control activity through reforms in order to strengthen the effectiveness in financial accountability and transparency of the local government areas in the state.

Keywords: Local government, internal control activity, financial accountability and Transparency

Introduction

The Local government is the third-tier of government created to bring the government closer to the people. The objectives for the creation of local government include to involve the people at the grassroots in the development of their area, and to ensure that resources are effectively mobilised, for meaningful development (Oviasuyi, Idada, and Isiraojie, (2010). This tier of government is administered by the local government council under the leadership of the local government chairman. The local government is constitutionally vested with numerous responsibilities and these responsibilities include among others the provision of education, healthcare, motor parks, markets, rural electrification, and construction of rural roads, culverts, and security. To discharge these responsibilities, local government has internal and external sources of finances; the revenue it generated internally and that from state and federation account (Local Government Financial Memoranda, 1997; Adeyemi, Akindele, Aluko and Agesin, 2012; Aramide and Bashir, 2015).

In line with above, it is the responsibility of local government management committee to ensure accountability and transparency in the disbursement of the above revenue in providing infrastructural services to the community to foster economic development at the grassroots level. This cannot be possible without effective internal control activity as a component of internal control system in the financial dealings of the local governments.

Local governments occupied a strategic position in public governance. The ordinarily expectation is that it should impact meaningfully on the socio-economic wellbeing of the people. However, this objective of the local government remains largely unachieved due to the prevalence of corruption, misstatement, misappropriation, embezzlement and other similar vices by those in charge of the management of financial resources at the local government (Odigbo, Auforo, and Edeoga, 2014). Internal control activity helps in controlling the malicious behaviours of both the public officials and the civil servants from corrupt practices. Then, to what extent is the control activity effective in strengthening financial accountability and transparency of the local government? Most of the studies reviewed discussed internal control and financial accountability without transparency. This study intends to fill this identified gap in literature by looking at the three in syntheses, regression techniques is also used for analysis which none of the studies reviewed including among others Ntongo, (2012), Hannah, (2013), Aramide and Bashir, (2015), Aristanti, (2015) has used this method to analyse the study variables, instead of the wide use of correlation statistics.

This research by assessing internal control activity, financial accountability and transparency at the local government provides a useful basis for policy formulation by the relevant authorities on what reforms are necessary to reposition the local government towards the achievement of its constitutional mandates.

Objective of the Study

The main objective of this study is to examine the effect of internal control activity on financial accountability and transparency in local government's areas of Borno State.

Hypotheses of the study

The study developed and tested three null hypotheses; H_{01} : There is no effective internal control activity in local government areas of Borno state, H_{02} : Control activity does not significantly affect financial accountability at the Local Government level, H_{03} : Control activity has no significant effect on financial transparency at the Local Government level,

Literature Review

Concept of Internal Control System

The concept of internal control system has been viewed as an integral part of any organization's financial and business policies and procedures. It consists of all measures taken by the organization for the purpose of protecting its resources against waste, fraud and inefficiency thereby ensuring accuracy and reliability of accounting and operating data, compliance with policies and procedure and evaluating the level of performance in all the units of the organization (Likis and Giriunas 2012; Kamau, 2014; Aramide and Bashir, 2015). This definition does not only mean internal control system involves all the means undertaken by the management of an organisation in safeguarding its resources against waste, fraud, inefficiency and compliance with applicable laws to obtain accuracy of financial data but also to assess the level of performance of the whole organisation.

Internal control systems consist of five inter-related components which is the responsibility of all employees from the management who design, implement and maintain it to the staffs that executes the various control activities. These components are: control environment, risk assessment, control activity, information and communication and monitoring control (COSO, 1998; INTOSAI, 2001; Kamau, 2014; Aristanti, 2015). Control activity as a component is the concern of this study while the other components are beyond this study.

Concept of Internal control activity

Internal control activity refers to the policies and procedures established by an organization to aid the directives issued by management in ensuring that activities are carried out in compliance with the established standards. It includes both manual and automated tools that help in prevention or reduction of risks that can affect accomplishments of organisation objectives (Gamage, Lock and Fernando, 2014; Yee, (2015)). It occurs throughout an organization and at all levels in all functions. (Kamau, 2014; Yee, 2015).

Control activity is categorized into three, namely; preventive, detective and corrective. The preventive control is essentially to prevent errors and fraud from occurring and it includes the following control elements; authorization and approval procedures, segregation of duties, control over access to resources and records. The detective control is to detect errors and fraud that have occurred. It includes such control elements as verifications/reconciliation, review of operating performance and supervision. The corrective controls help to identify and reduce or eliminate the causes of a problem that resulted into errors, omission, misstatement and any malicious act from happening. It is an adequate balance between detective and preventive controls necessary to complement control activities in order to achieve the organizational objectives. Errors that failed to be prevented and detected are corrected through corrective controls (Labaran, 2008; Kamau, 2014; Aramide and Bashir, 2015).

Internal control activity ensures that the authorization procedure should be documented and clearly communicated to employees so as to reduce the risks of error, waste, or wrongful acts. It requires that no single person neither office should carry out a transaction from the beginning to the end and that employees schedule not to be fixed but rather that duties and responsibilities are assigned to separate individuals and office and also schedules be rotated (INTOSAI, 2001; Ntongo, 2012; Minja, 2013). Aristanti, 2015). This is to ensure that employees work provides checks on others and effective checks and balances to exist so that corrective action is taken to address weaknesses identified. It restricts access to resources and records of the organization to only authorized individuals who can account for the custody and/or use of the resources, transaction be verified before and after processing and also it ensures that actual accomplishment should meet the established standard or objectives (Labaran, 2008; Hannah, 2013; Wakiriba, Ngahu, and Wagoki, 2014; Yee, 2015).

Aramide and Bashir (2015) opined that the process of financial accountability can only be effective through proper internal control activity which is supposed to be a useful mechanism for financial accountability and transparency at local government. Litvack, (2016) documented that the higher the level of accountability, the more transparent the local government is perceived to be. Transparency depends on accountability and the latter

on the effectiveness of internal control activity in operation. This study therefore examines the effect of internal control activity on financial accountability and transparency in local government areas of Borno state.

Concept of Accountability and Transparency

The concept of accountability refers to the manner how resources are used in relation to objectives (Mohammed, 2015). Accountability draws its origin from financial accounting which is focused on checking the way the books are kept and how the money is spent (Rabrenovic 2007). It is the obligation for public officials to report on the usage of public resources and to achieve performance standards as it relates specifically to the public sector. However, Khan (2010) construed it as the obligation to render an account for responsibility conferred. Apaza (2011) opined that an individual who is assigned a task need to be constrained over the power exercised. Financial accountability therefore, is concern with tracking and reporting on allocation, disbursement and utilization of financial resources, using the tools of auditing, budgeting and accounting (Brinkerhoff (2001). The concept of local government financial accountability therefore, is the degree to which the local government explains or justifies what it have done or fail to do to the public or people within its jurisdiction. It connotes the degree to which those entrusted with public funds apply it for the purposes meant and for the good of the people, financial accountability ensures that the public money is used in a responsible and productive manner. It involves the verification of legality and regularity of financial accounts to ensure that the rules and regulations in relation to the programmes and projects under the local government are complied and also to ensure that the value for money is obtained in the use of the resources (Rabrenovic 2007). Ibietan (2013) also in similar view, that financial accountability demands that government at all levels to ensure that the public funds or resources are judiciously utilized and be backed with an adequate and appropriate records that is supposed to be made publically available and accessible and on time for the public assessment to ensure transparency.

The concept of transparency on the other hand, extends to rules settings such as rule of law, accountability, public participation and deliberative democracy. Therefore, for information or process to be transparent, is for it to be open and available for examination and scrutiny manner. The degree of transparency depends upon which records, proceedings, or data are available and which are not available (Bauhr and Grimmes, 2012; Mohammed, 2015).

The transparency laws provides that information on financial dealings of government should be managed and published in time and to be accurate, complete, up to date, reliable and made available in sufficient time to permit analysis, evaluation by relevant stakeholders (Transparency and Accountability Initiative, 2016).

Transparency and accountability are mutually reinforcing, because both enable citizen to have a say about issues that matters them and a choice to influence decision –making and hold those making decisions to account (Folscher, krafchik and Idada, 1999). Each of the concepts is a part of strategy used for and by citizens to have the means, resources and opportunities to influence decision-making and affect development outcome (Shende and Bennett, 2004; Transparency and Accountability Initiative, 2016).

Financial Accountability and Transparency in Local Government

The management of local governments require fund for the purpose of discharging the government constitutional functions such as the provision of projects and services (Abebe, 2012; Samuel, 2012). It is the discharge of this functions that result in public expenditure and create the need for accountability and transparency (Samuel, 2012) in which the local government citizens wanted to know whether the local government has judiciously utilized the fund or not. In a situation where judicious utilisation has not been done, accountability sanction can be applied for correction of any illegal, or malicious behaviour. The bedrock of financial accountability is to identify, punish and correct wrong doing to encourage and acquire improvement in the effectiveness and efficiency in the use of public funds (Hedges and Blick 2008). As such, citizens of a country look up to the legislative bodies for holding the executive accountable for management of public debt and expenditure on public programmes (Khan, (2010).

The applications of sanctions for illegal or inappropriate action or behaviour improve accountability and transparency in the public sector (Brinkerhoff 2001). The local government like any other tier of government is expected to apply public resources for the good of the people under her jurisdiction. To ensure this, there are clearly defined rules and regulation to public expenditure at the local government. The budget form the basis upon which Local Government fund can be spent and it provides that expenditure conform to the budget. The essence of this provision is to achieve value for money at the local government and prevent a situation where the management of the local government diverted funds meant for public good for personal use. Unfortunately, these rules seem to be neglected as there are reported cases of corruption, embezzlement and misappropriation of public funds at the local government level in Nigeria (Adeyemi, Kindele, Aluko and Agesin, 2012; Boris, 2015; Coker and Adams, 2012). Due process in the utilization of funds at the local government seems not to be observed by those in leadership position .Whereas, public fund at that level of government are supposed to be used economically, efficiently, and effectively in order to maximise output beneficial to the populace

(Rabrenovic, 2007; Abebe et al, 2012).

Effect of Internal Control Activity on Financial Accountability and Transparency at the Local Government

Internal control activity in local government ensures that activities are carried out in compliance with the rules and regulations for prevention or reduction of risks that can affect accomplishments of its objectives. For internal control activity to be effective, the policies and procedures established addresses the risks that are related to the achievement of the local government's objectives and are appropriate, comprehensive, cost effective, reasonably and functioning consistently according to plan throughout the period and relates to control objectives (INTOSAI, 2001).

The aim of internal control activity includes fraud prevention, provision of reliable reports and safeguarding assets of the local government (Ntongo, 2012; Minja, 2013). The control activity if adequately established and working effectively as planned is a mechanism for financial accountability and transparency at local government. This is evidenced by Brinkerhoff (2001) and Rabrenovic (2009) who states that the higher the level of internal control activity, the more financially accountable in the activities of an organization.

Wakiriba, Ngahu, and Wagoki (2014) opined that for financial accountability there must be an effective financial control system supported by the presence of clear separation of roles, supervision and commitment of management on the implementation of internal controls.

Aristanti (2015) was of the view that control environment, control activity and supervision significantly affect financial accountability.

METHODOLOGY

The study adopted cross sectional survey research design. The choice of this research design is because the study is concerned with eliciting the perception of stakeholders on the effect of internal control activity on financial accountability and transparency at the local government areas of the Southern senatorial zone consists of nine local government areas include; Hawul, Biu, Shani, Kwaya-Kusar, Bayo, Damboa, Chibok, Gwaza and Askira-Uba.

Data was collected through questionnaire from the selected respondents. The questionnaire is the structured type, essentially based on five points Likert scale ranging from strongly agree (1) to strongly disagree (5). This study used both primary and secondary sources of data. The primary source is obtained through questionnaire while the secondary sources were obtained from textbooks, journal, publications, conference papers and internet materials. The data generated by the research was analysed using chi-square statistical technique and based on the result of the data analysis, conclusion was drawn and recommendation made.

The study drew a sample of 330 out of a population of 1886 staff from treasury and finance, audit and administration departments as well the local government council members (legislative arm) of five local governments out of the nine. The choice of these departments is because they are directly related to the subject matter compared to the other departments not chosen. Purposive sampling technique was adopted whereby the southern senatorial zone out of the three senatorial zones is selected, and from the nine local government areas of the southern senatorial zone, five is adopted.

Model Specification

The study adopted some model in expressing the hypothesised relationship between the independent variables (control activity) and the dependent variables (financial accountability and financial transparency) of the local government areas of Borno state. The models are as follows:

$$FNA = \beta_0 + \beta_1 COA + ut \dots \text{Model.. (i),}$$

$$FNT = \beta_0 + \beta_1 COA + ut \dots \text{Model.. (ii)}$$

Where;

FNA = Financial accountability

FNT = Financial transparency

COA = Control activity

COE = Control environment

IFC = Information and communication

$\beta_0 \dots \beta_1$ = Regression coefficient

Ut = Random error term

RESULTS AND DISCUSSION

Questionnaire Response Rate

The response rate of the administered questionnaires per department from the five local government areas under study is presented in table 1.

Table 1: Questionnaire Response Rate

Respondents/Department	Administered	Returned	Response rate (%)
Administration	202	199	61.0
Treasury/Finance	113	112	34.3
Audit	5	5	1.5
LGC members	10	10	3.0
Total	330	326	100

Source: Field Survey, 2017.

Table 1 shows that 330 questionnaires were administered but 326 were duly filled and returned which represents 98% response rate of the respondents. According to Hannah (2013), any response rate from 50% and above is appropriate for analysis. Therefore, the response rate of 98% is adequate for this study. Specifically, table 1 shows that the majority of respondents were from the Administrative Department; 199(61%), followed by 112 (34%) from Treasury and Finance Department, Local Government Council Members constituting 10 (3%) and the last was Audit Unit with 5 (2%).

Test of Hypotheses

The study adopted the use of Chi-Square (X^2) statistical technique to test hypothesis one (H_{01}) which state; “there is no effective internal control activity in local government areas of Borno state” and hypothesis two (H_{02}) which state that “there is no high degree of financial accountability and transparency in local government areas of Borno state”.

The study adopted the use of Chi-Square (X^2) analysis to achieve research hypothesis one (H_{01}) which states that “There is no effective internal control system in local government areas of Borno state

Table 2: Chi-square test result on the effectiveness of internal control system in local government in Borno state

		Rows: Worksheet rows		Columns: Worksheet columns		
	Disagree	Strongly Disagree	Undecided	Agree	Strongly Agree	All
Male	97 97.50	315 315.0	434 433.9	561 560.9	233 232.7	1640
Female	58 57.5	186 186.0	256 256.1	331 331.1	137 137.3	968
All	155 Cell Contents:	501 Count	690 Expected count	892	370	2608
Pearson Chi-Square = 0.007, DF = 4, P-Value = 1.000						
Likelihood Ratio Chi-Square = 0.008, DF = 4, P-Value = 1.000						

Table 2 indicates that Chi- Square (X^2) computed value is 0.007 while the table value is 9.49 at 5% level of significance and at four (4) degree of freedom (df). Since the computed X^2 value is less than X^2 table value, it is therefore concluded that internal control activity (Coa) is not very significantly effective in local government areas in Borno state. This implies that internal control activity in the local government areas of Borno state do not achieve the objectives for which they were established.

Effect of Internal Control Activity on Financial Accountability

To determine the effect of internal control activity on financial accountability, Thus, the relationship between internal control activity is estimated with financial accountability as the dependent variable of the model 1. The study adopted the use of Ordinary Least Square (OLS) statistics to test research hypothesis two (H_{02}) which states that “Internal control activity has no significant effect on financial accountability in local government areas of Borno state”. Table 3 presents the summary and interpretation of the result.

Table 3: Result of the effect Internal Control Activity on Financial Accountability

$$\begin{aligned} \text{FNA} &= 6.237 - 0.9728 \text{ COA} \\ (\text{Se}) &= (1.562) \quad (0.34011) \\ t^* &= 3.99^* \quad -2.860^* \\ R^2 &= 0.72 \\ \text{D.W} &= 2.31 \end{aligned}$$

*Note: Standard errors in parenthesis
t- Statistics in asterisk*

Based on the regression result presented in table 3, the variable financial accountability (FNA) is inversely related to the variable control activity in the model. Thus, control activity (COA) in the model has negative impacts on the dependent variable being financial Accountability (FNA).

The coefficient of the variable control activity (COA) – 0.9728 suggest that if control activity should increase by 1 percentage point, financial accountability will decrease by -0.9728 units. However, this variable is not statistically significant in inflecting financial accountability.

The R^2 of the model being 0.72 suggest that about 72% of the variation in financial accountability (FNA) is explained by the control activity in the model. This implies that about 28% of variation in financial accountability is explained by the entire variables not captured in the model. The Durbin Watson (D.W) statistics of the model being 2.31 suggest that the explanatory variables in the model are not serially correlated.

Effect of Internal Control Activity on Financial Transparency

To determine the effect of internal control activity on financial transparency in the local government areas, internal control activity is estimated with financial transparency as the dependent variable of the model 2. The study also adopted the use of Ordinary Least Square (OLS) statistics to test research hypothesis four (H_{02}) which states that “Internal control activity does not significantly affect financial transparency in local government areas of Borno state”. Table 4 presents the summary and interpretation of the result.

Table 4: Result of the effect of Internal Control Activity on Financial Transparency

$$\begin{aligned} \text{FNT} &= 2.906 + 0.2384 \text{ COA} \\ (\text{Se}) &= (2.166) \quad (0.4714) \\ t^* &= 1.34^* \quad 0.505^* \\ R^2 &= 0.34 \\ \text{D.W} &= 1.87 \end{aligned}$$

*Note: Standard errors in parenthesis
t- Statistics in asterisk.*

Table 4 shows that the variable financial transparency (FNT) has a positive relationship with control activity (COA). This implies that control activity has a positive impact on financial transparency. The coefficient of the variable control activity (COA) being 0.2384 suggests that if control activity should increase by 1 percentage point, Financial Transparency (FNT) will increase by +0.2384 Units. The R^2 of the model being 0.34 suggest that 34% of variations in financial transparency are explained by all the variables not captured in the model. The Durbin Watson (D.W) statistics being 1.87 suggest the presence of slight serial correlation among the explanatory variables in the model.

CONCLUSION AND RECOMMENDATIONS

Internal control system is not very effective in the local government areas of Borno state, hence, it has no significant impact on the financial accountability and transparency. To ensure internal control activity effectiveness, the Borno state government through Ministry of local government affairs in conjunction with the local governments’ management should revisit the policies and procedures of internal control activity of the local government areas and reform the system in order to strengthen its effectiveness. This can be done through ensuring that all the five components of internal control system are present and effectively and efficiently working in all the local government areas of the state.

There should be an established financial accountability and transparency unit at the local government level which will serve as a mandate of ensuring financial accountability and transparency in local government dealings.

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